Canadian tax considerations for windpower and solar power projects

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The following is a brief summary of the main Canadian federal income tax considerations applicable to windpower and solar power projects in Canada and, in particular, the accelerated capital cost allowance rates for qualifying depreciable property and the Canadian renewable conservation expense regime.

Accelerated Capital Cost Allowance Rate

“Capital cost allowance” (CCA) is essentially depreciation for Canadian federal income tax purposes. CCA deductions are discretionary and are taken on a declining balance, class-by-class basis. For example, if the capital cost of depreciable property of a particular class is $100 and the CCA rate for the class is 30%, CCA to a maximum of $30 may be claimed in respect of the property in the first year (subject to the half-year rule discussed below). If $20 of CCA is claimed, this amount is deducted from the capital cost to arrive at the “undepreciated capital cost” (UCC) and the 30% rate is applied to this amount to determine the maximum deduction in the following year (in this example, $24). The cost of newly acquired property of the same class is added to the UCC and proceeds from the sale of property in the class (up to the original cost of the property) is deducted from the UCC. If the UCC is negative at the end of a year, the negative amount (known as recapture) is included in computing income in that year.

CCA classes 43.1 and 43.2 of the regulations (the Regulations) under the *Income Tax Act* (the Act) provide enhanced CCA rates for various renewable asset properties. Certain assets of a qualifying wind energy conversion system or photovoltaic system that are included in class 43.1 will be entitled to an accelerated CCA rate of 30% per year. Such assets that are acquired after February 22, 2005 and before 2020 and that would otherwise be included in Class 43.1 are included in class 43.2, which has a CCA rate of 50%.

Subject to certain exceptions, Class 43.1 includes

1. a fixed location device that is a wind energy conversion system that
    1. is used by the taxpayer primarily for the purpose of generating electrical energy, and
    2. consists of a wind-driven turbine, electrical generating equipment and related equipment, including
        1. control, conditioning and battery storage equipment,
        2. support structures,
        3. a powerhouse complete with other ancillary equipment,

4. transmission equipment; and

2. fixed location photovoltaic equipment that is used for the purpose of generating electrical energy from solar energy consisting of solar cells or modules and related equipment including inverters, control, conditioning and battery storage equipment, support structures and transmission equipment.

There are certain limitations that apply in determining the amount of CCA that may be deducted in any given taxation year. By virtue of the “available for use rules” in the Act, CCA for a Class 43.1 or 43.2 property that has been acquired and which is not considered available for use at the end of a taxation year may be restricted until such time as the property is available for use. In addition, property that becomes available for use in the year is subject to the “half-year” rule found in the Regulations, whereby only 50% of the normal CCA deduction is permitted in the year an asset becomes available for use. Finally, CCA is prorated in circumstances in which the taxpayer’s taxation year is less than 365 days.

Property included in Class 43.1 or 43.2 may be “specified energy property” in which case, the CCA that may be deducted by a taxpayer in respect of such property is limited to the taxpayer’s income from the business of selling the product of the property. This limitation does not apply to a corporation whose principal business is manufacturing or processing, mining operations or the sale, distribution or production of electricity, natural gas, oil, steam, heat or any other form of energy or potential energy, or to a partnership each member of which is such a corporation.

Canadian Renewable and Conservation Expense (“CRCE”)

Certain expenses incurred by a taxpayer in the pre-production development phase of renewable energy and energy conservation projects, for which it is reasonable to expect that at least 50% of the capital cost of the depreciable property to be used in the project would qualify for inclusion in Class 43.1 or 43.2, may qualify as CRCE if, among other things, they are not:

1. payable to a person or partnership with whom the taxpayer is not dealing at arm's length (such as a parent, subsidiary or sister company), or
2. specifically excluded from CRCE under subsection 1219(2) of the Regulations (see below).

Where expenses qualify as CRCE, they may be deducted entirely in computing Canadian taxable income in the year they are incurred or carried forward indefinitely and deducted in later years.

Examples of the types of expenses that are typically eligible for CRCE include expenses incurred by a taxpayer:

1. for the purpose of making a service connection to the project for the transmission of electricity to a purchaser of the electricity to the extent that the expense was not incurred to acquire property;
2. to determine the extent, location and quality of energy resources;
3. for clearing land to the extent necessary to complete the project;
4. for the construction of a temporary access road to the project site; and
5. for a “test wind turbine” that is part of a wind farm project of the taxpayer.

Examples of the types of expenses that are not eligible for CRCE include:

1. amounts that would otherwise be included in the capital cost of depreciable property, including all costs directly associated with the acquisition and installation of the property, except those described in i) to v) above as qualifying as CRCE;
2. financing and interest charges;
3. administration and management expenses;

4. amounts paid to a non-resident person or a partnership any of the members of which is not a resident of Canada; and
5. costs related to the acquisition or use of land, as well as the grading and levelling of land, except those described in i) to v) above as qualifying as CRCE.
6. The determination of whether a particular expense incurred by a taxpayer will qualify for inclusion in CRCE must be made based upon a review of all of the facts relevant to a particular situation.

Special Rules Applicable to Limited Partnerships

Where windpower or solar power projects are carried on through limited partnerships, additional considerations arise. A partnership is not a taxpayer for Canadian tax purposes. Rather, a partnership computes its income (or loss) as a separate person resident in Canada and then allocates the income or loss to its partners. If a taxpayer is a member of a partnership at any time in a particular taxation year, it will include in computing its income its share of the income or loss of the partnership for any fiscal period of the partnership ending in, or at the same time as, such taxation year.

There are two exceptions to this general scheme that are relevant to limited partnerships that carry on windpower or solar power projects. First, any CRCE incurred by a partnership is not deductible in computing income or loss that is allocated to its partners but, instead, each partner deducts directly its share of any CRCE incurred by the partnership. In addition, in the case of a limited partner, the deduction of any loss of the partnership or CRCE incurred by the partnership is restricted to the limited partner's "at-risk amount". Generally, a limited partner's at-risk amount in respect of its interest in the partnership at any time is equal to the cost of the limited partner's interest in the partnership plus any income allocated to the partner for fiscal periods ending prior to that time less the sum of any losses of the partnership allocated to the partner for fiscal periods ending prior to that time and any distributions received by the partner from the partnership before that time. To the extent that a limited partner's share of the loss from the partnership or CRCE incurred by the partnership exceeds the partner's at-risk amount, such loss or CRCE may be deducted in a subsequent year to the extent that the amount of the loss or CRCE does not exceed the partner's at-risk amount in that subsequent year.